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FILED/ACCEPTED

SEP 28 2010

Federal Communications Commission
Office of the Secretary

September 28, 2010

BY HAND DELIVERY

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: *Request for Review of Decision of the Universal Service Administrator*
CC Docket No. 96-45

Dear Ms. Dortch:

In accordance with sections 54.719(c) and 54.722 of the Federal Communications Commission's rules, 47 C.F.R. §§ 54.719(c), 54.722, Virgin Islands Telephone Corp. d/b/a Innovative Telephone hereby submits an original and four copies of its Request for Review of Decision of the Universal Service Administrator.

Also enclosed is a duplicate of this filing, which I would kindly appreciate your date-stamping. Please contact the undersigned at (202) 719-7524 if you have any questions regarding this filing.

Respectfully submitted,

Bennett L. Ross

Enclosures

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No. of Copies rec'd 0+4
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ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FILED/ACCEPTED

SEP 2 8 2010

Federal Communications Commission
Office of the Secretary

In the Matter of	)	
	)	
Request for Review by	)	CC Docket No. 96-45
Virgin Islands Telephone Corp. d/b/a	)	
Innovative Telephone of Decision of	)	
Universal Service Administrator	)	
	)	

VIRGIN ISLANDS TELEPHONE CORP. D/B/A INNOVATIVE TELEPHONE'S REQUEST FOR REVIEW OF DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR

I. STATEMENT OF INTEREST AND ISSUES

Pursuant to sections 54.719(c), 54.721 and 54.722 of the Commission's rules,[1] the Virgin Islands Telephone Corp. d/b/a Innovative Telephone ("Innovative") hereby seeks review of the Universal Service Administrative Company ("USAC") management response to the Independent Auditor's Report HC-FL-042, which was a follow-up audit to HC-2007-382 that evaluated Innovative's compliance with the requirements of the Federal High Cost Universal Service Program for the period from July 1, 2006 through June 30, 2007.[2]

Innovative is not challenging any of the Auditor's findings or the vast majority of USAC's determinations in its management response to the audit. Rather, Innovative seeks Commission review of a narrow issue – namely, USAC's decision to reject the Auditor's conclusion regarding the proper treatment of the deferred tax asset. USAC's decision is contrary

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[1] 47 C.F.R. §§ 54.719(c), 54.721, and 54.722.

[2] *See* Appendix A (Report on Follow-Up to Examination HC-2007-382, VITELCO-Innovative SAC 643300, for the Year Ended June 30, 2007 submitted by McBride, Lock & Associates ("Auditor")); Appendix B (Letter to Joyce Campbell, Innovative, from USAC, High-Cost and Low-Income Division (dated July 30, 2010)).

to written policies and guidelines of the National Exchange Carrier Association, Inc. ("NECA"), which were established in 2007 based on guidance from the Commission. These policies and guidelines are set forth in memoranda from NECA to its member companies dated March 9, 2007 and June 13, 2007 (copies attached as Appendix C and Appendix D, respectively). For the reasons set forth below, the Commission should reverse USAC's determination regarding the treatment of the deferred tax asset and direct USAC to calculate Innovative's Interstate Common Line Support ("ICLS") and High Cost Loop support during the audit period by incorporating all applicable interstate deferred tax asset balances for Innovative.[3]

II. STATEMENT OF FACTS

Innovative is the incumbent local exchange carrier in the U.S. Virgin Islands, operating pursuant to a franchise granted by the USVI Government in 1959.[4] Innovative is a Virgin Islands corporation and is headquartered on St. Thomas.

Prior to July 1, 2010, Innovative was a rate-of-return regulated carrier at the interstate level.[5] While subject to rate-of-return regulation, Innovative was a participating member of

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[3] The proper recognition of the interstate deferred tax asset would result in underpayments to Innovative in the amount of $2,820,844 for ICLS and High Cost Loop support during the 12-month audit period ended June 30, 2007as related to Finding 2 of the Auditor's Report HC-FL 042. With respect to overall audit findings, the proper recognition of the deferred tax asset for Finding 2 would reduce from $6,016,971 to $3,196,127 the total recovery of high cost funds from Innovative.

[4] Franchise for the Virgin Islands Telephone Corporation (Oct. 31, 1959); Act No. 504 of the Third Legislature of the Virgin Islands, Authorizing the Sale of the Virgin Islands Telephone System, the Granting of a Franchise, and for Other Related Purposes (approved Oct. 9, 1959), 1959 V.I. Sess. Laws pp. 193-202.

[5] *Petition of Virgin Islands Telephone Corp., for Election of Price Cap Regulation and Limited Waiver of Pricing and Universal Service Rules; China Telephone Company, FairPoint Vermont, Inc., Maine Telephone Company, Northland Telephone Company of Maine, Inc., Sydney Telephone Company, and Standish Telephone Company Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief; Windstream Petition for Limited Waiver Relief*, Order, 25 FCC Rcd 4824 (2010) (granting Innovative's petition to convert to price cap regulation).

NECA, which represents more than 570 rural rate-of-return regulated telecommunications carriers. NECA's primary responsibilities involve preparing interstate access tariffs and administering related revenue pools on behalf of its member companies.[6]

Pursuant to Commission rules, NECA collects cost, demand, and revenue data from its member companies that are used in preparing the annual tariff filing setting out interstate access rates to be charged to interstate access customers.[7] Member companies performing cost studies must submit costs, demand and access revenue data to NECA,[8] and certify "the data have been examined and reviewed and are complete, accurate, and consistent with the rules of the Federal Communications Commission."[9]

The Commission mandates the specific accounts and sub-accounts NECA member companies must use in keeping their books of account for revenues, investments, and expenses pursuant to Parts 32 and 64 of its rules.[10] Commission accounting rules specify the types of costs that can be included in accounts, how carriers are required to separate their regulated costs from nonregulated costs, and how to account for services and transactions between affiliates and these member companies.[11]

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6 *MTS and WATS Market-Structure,* Third Report & Order, FCC Docket No. 78-72, Phase I, 93 FCC 2d 241, ¶ 339 (1983)("*Access Third Report & Order*").

7 47 C.F.R. § 69.601(a).

8 *Id.*, § 69.605(a).

9 *Id.*, § 69.601(c). NECA is also required to calculate monthly pool revenue distributions based on the access revenue, demand, and cost data reported by member companies, *id.*, § 69.605(a); reimburse "cost" companies for access expenses to the extent their reported costs exceed their reported revenues, *id.*, §§ 69.607-.610; and distribute the pool "residue" or return on investment, in accordance with FCC rules, *id.*, § 69.605(d).

10 47 C.F.R. Parts 32 and 64.

11 47 C.F.R. § 64.901, *et seq.*; *see also Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, Report & Order, Order, 2 FCC Rcd. 1298, (1987), *aff'd sub nom., Southwestern Bell Corp. v. FCC*, 896 F.2d 1378 (D.C. Cir. 1990).

Under Commission rules, NECA member companies must utilize account 4340, Net non-current deferred operating income taxes, to reflect "accumulated deferred federal income taxes resulting from differences in taxes computed using booked depreciation expense calculated on a straight line basis, and taxes paid to the IRS that result from use of accelerated depreciation methods."[12] According to NECA, "Because taxes paid under accelerated IRS depreciation methods are presumably lower than taxes calculated using booked (straight-line) depreciation methods, there should normally be a positive (credit) balance in account 4340, representing the difference between regulated taxes calculated for revenue requirements and the lower taxes actually paid to the IRS."[13]

However, for a variety of reasons, negative balances may occur in Account 4340, which results in a deferred tax asset. In fact, Innovative's financial results reported negative balances in Account 4340 for the years 2004 and 2005.[14]

NECA took the position that the Commission's Part 65 rules did not permit negative balances in Account 4340 (deferred tax asset) because, according to NECA, it "could have the

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12 Memorandum from Carol A. Brennan and Richard R. Snopkowski, NECA, to General Contacts at all NECA Member Companies regarding Negative Balances in Account 4340 Net Non-Current Deferred Operating Income Taxes (Aug. 8, 2006) ("NECA August 2006 Memorandum)" (copy attached as Appendix E).

13 *Id.*

14 The deferred tax balances reported in Innovative's original cost study and USF filings for the years 2004 and 2005 were incorrectly reported based on amounts applicable to Innovative's local jurisdiction. In addition, 2004 data initially were incorrectly reported as deferred tax liabilities. These reported amounts were corrected to reflect Innovative's actual interstate jurisdictional amounts in the cost study and USF data provided to the Auditor in the course of the USAC audit process. The correction to reflect deferred tax asset balances using Innovative's interstate jurisdictional amounts is consistent with and directly related to the Auditor's adjustment to reflect accumulated depreciation balances using Innovative's interstate jurisdictional amounts – an adjustment USAC accepted. Appendix A (Report on Follow-up to Examination HC-2007-382, McBride, Lock & Associates Independent Auditors' Report, dated September 21, 2009, at 4-5 - FINDING 3: REVISED FILINGS AND ERRONEOUS REGULATED BALANCES).

anomalous effect of increasing the rate base."[15] As a result, "pending further clarification from the FCC," NECA adopted a policy that required negative balances in Account 4340 to be adjusted to a minimum of zero for pool and high cost loop reporting. Consistent with this policy, NECA disallowed negative balances in Account 4340 from Innovative's cost study and universal service fund filings and reported zero deferred taxes in Innovative's filings with USAC.

However, after consulting with the Commission, NECA changed its policy regarding Account 4340 negative balances. Specifically, on March 9, 2007, NECA issued guidance (unbeknownst to Innovative at the time) which indicated that, based on "informal guidance" from Commission staff, NECA would permit member companies to "recalculate their rate base amounts to reflect negative Account 4340 balances" and to use the resulting adjustments for purposes of NECA pool settlements as well as ICLS and High Cost Loop support.[16] In June 2007 (again unbeknownst to Innovative at the time), NECA permitted companies affected by its "*former practice* of allowing only positive balances in Account 4340 to recalculate their rate base amounts associated with regulated activities to reflect negative Account 4340 balances."[17] Thus, for purposes of the time period that was the subject of the audit at issue, NECA accepted negative balances in Account 4340 in rate base calculations for ICLS and High Cost Loop support purposes.[18]

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15 Appendix E (NECA August 2006 Memorandum at 1).

16 Appendix C (Memorandum from Carol A. Brennan and Richard R. Snopkowski, NECA, to General Contracts at all NECA Member Companies regarding Negative Balances in Account 4340 (March 9, 2007)).

17 Appendix D (Memorandum from Carol A. Brennan and Richard R. Snopkowski, NECA, to General Contracts at all NECA Member Companies regarding Negative Balance Adjustments to Account 4340 (June 13, 2007) (emphasis added)).

18 Innovative has no record of having received either the March 2007 or June 2007 correspondence from NECA and or any instructions, verbal or otherwise, from NECA personnel regarding its change in policy. Indeed, when NECA conducted a review of Innovative's 2006

On behalf of USAC, the Auditor conducted an Improper Payment Information Act ("IPIA") performance audit of Innovative for the year ended June 30, 2007. Among other findings that are not at issue here, the Auditor found that Innovative originally reported accumulated depreciation and deferred tax assets using Innovative's local jurisdictional amounts and that, based on then NECA policies, did not include negative balances in Account 4340, Net non-current deferred operating income taxes, in originally reported data for ICLS and High Cost Loop support purposes. As the Auditor noted, "[t]he carrier was instructed by NECA that a deferred tax asset should not be reported in the rate base since it was an upward adjustment to the rate base."[19] However, because NECA subsequently changed its policies regarding negative balances in Account 4340, the Auditor recommended that Innovative "report the deferred tax asset balance as reported in account 4340 and as separated through the Part 64, Part 36, and Part 69 cost studies for the applicable High Cost Program filings."[20] The Auditor's recommendation regarding the treatment of Account 4340 is entirely consistent with NECA policies and guidelines in effect during the audit period, and the Auditor's proposed adjustment for the recognition of deferred tax assets was computed based on amounts applicable for Innovative's interstate jurisdictional reporting.

Nevertheless, USAC did not accept the Auditor's recommendation regarding Account

(Continued . . .)
cost study in the fall of 2007, NECA's representatives did not advise Innovative of the change in policy that would have permitted Innovative to report negative balances in Account 4340. Innovative did not learn about NECA's change in policy regarding Account 4340 until 2008, at which time, in consultation with the Auditor, Innovative determined that the most administratively efficient manner to address the issue was to submit a corrected cost study and USF data through the USAC audit process.

19 Appendix A (Report on Follow-up to Examination HC-2007-382, McBride, Lock & Associates Independent Auditors' Report, dated September 21, 2009, at 3 - FINDING 2: DEFERRED TAX ASSET).

20 *Id.*

4340. In its Management Response to the audit, USAC disagreed with the Auditor's determination that a negative balance (deferred tax asset) in Account 4340 is allowable for purposes of determining ICLS and High Cost Loop support. According to USAC, Innovative "acted consistent with the direction of NECA, the Part 36 Collection Agent and Common Line Pool Administrator for the period in question. USAC does not act contrary to NECA guidance and/or NECA administrative policies concerning treatment of deferred taxes without guidance from the FCC."[21]

III. ARGUMENT

The Commission should reject USAC's erroneous determination regarding the treatment of a negative balance (deferred tax asset) in Account 4340. USAC's apparent belief that NECA's policy in effect during the audit period (July 1, 2006 through June 30, 2007) was to allow only positive balances (liabilities) in Account 4340 for ICLS and High Cost Loop support purposes is simply wrong. Indeed, in its written guidance issued in March and July 2007, NECA made plain that negative balances (deferred tax asset) in Account 4340 were permitted and expressly allowed member companies to recalculate their rate base amounts associated with regulated interstate activities to reflect such negative balances.

During the audit, consistent with the NECA policies and guidelines referenced above (and attached to this Petition), Innovative provided the Auditor with corrected cost study and USF data in support of the inclusion of the Company's interstate deferred tax asset balances for all relevant periods. The Auditor agreed with Innovative's position on this issue and recommended, consistent with NECA's policies and guidelines, that Innovative include all applicable interstate deferred tax asset balances for ICLS and High Cost Loop support purposes.

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21 *Id.* (USAC Management Response to HC-2007-382, dated March 22, 2010, at 1, Finding 2).

Not surprisingly, Innovative's response to the Auditor on this issue was to concur with the audit findings.

According to USAC, it is not at liberty to "act contrary to NECA guidance and/or NECA administrative policies concerning treatment of deferred taxes without guidance from the FCC."[22] However, while paying lip service to NECA guidance and policies, USAC inexplicably either ignored or overlooked them in deciding to disregard applicable interstate deferred tax asset balances for Innovative in determining the Company's ICLS and High Cost Loop support. USAC's decision is impossible to square with the guidance issued and policies adopted by NECA in March and July 2007 that ICLS and High Cost Loop support for member companies should be calculated by incorporating all applicable interstate deferred tax asset balances. Importantly, NECA issued this guidance and adopted these policies after consulting with the Commission on the proper treatment of negative balances in Account 4340.

Consistent with NECA's guidance and policies and the Auditor's findings, Innovative should be entitled to incorporate all applicable interstate deferred tax asset balances for ICLS and High Cost Loop support purposes for the audit period. Thus, the Commission should reject USAC's determination to the contrary.

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22 *Id.*

IV. CONCLUSION

For the foregoing reasons, the Commission should reject USAC's determination regarding the treatment of negative balances in Account 4340 and instruct USAC to calculate Innovative's ICLS and High Cost Loop support during the audit period incorporating all applicable interstate deferred tax asset balances for Innovative.

Respectfully submitted,

September 28, 2010

Bennett L. Ross
WILEY REIN LLP
1776 K Street, NW
Washington, DC 20006
(202) 719-7000

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of September, 2010, I caused copies of the foregoing Request for Review By Virgin Islands Telephone Corp. d/b/a Innovative Telephone of Decision of the Universal Service Administrator to be served upon the following party by first-class mail:

Universal Service Administrative Company
Attention: David Capozzi, Acting General Counsel
2000 L Street, N.W., Suite 200
Washington, DC 20036

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Request for Review by	)	CC Docket No. 96-45
Virgin Islands Telephone Corp. d/b/a	)	
Innovative Telephone of Decision of	)	
Universal Service Administrator	)	
	)	

DECLARATION OF JOYCE A. CAMPBELL

I, Joyce A. Campbell, do hereby, under penalty of perjury, declare and state as follows:

1. My name is Joyce A. Campbell. I am a certified public accountant and am employed by Virgin Islands Telephone Corp. d/b/a Innovative Telephone ("Innovative") as Controller - Internal Audit/Separations/Plant. In that capacity, I am familiar with the cost studies and related information that Innovative files with the Universal Service Administrative Company ("USAC") and the National Exchange Carrier Association, Inc. ("NECA") in connection with federal universal service support. I also am familiar with the audit conducted on behalf of USAC regarding Innovative's compliance with the requirements of the Federal High Cost Universal Service Program for the period from July 1, 2006 through June 30, 2007.

2. In accordance with Commission rules, 47 C.F.R. § 54.721(b), I have reviewed the factual assertions set forth in Innovative's Petition for Review and hereby certify that such factual assertions are true and correct to the best of my knowledge.

Joyce A. Campbell

Joyce A. Campbell

Dated: September 27, 2010

Appendix A

Report on Follow-up to Examination HC-2007-382

Vitelco-Innovative
SAC 643300

For the Year Ended June 30, 2007

HC-FL-042

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CERTIFIED PUBLIC ACCOUNTANTS

McBRIDE, LOCK & ASSOCIATES

INDEPENDENT AUDITORS' REPORT

Wayne Scott
Vice-President, Internal Audit
Universal Service Administrative Company:

We have completed a performance audit of Vitelco-Innovative SAC 643300 Examination HC-2007-382 (the "Beneficiary") during the year ended June 30, 2007 in supporting the effective and efficient implementation of the USF program and to help ensure that entities receiving support (USF "participants") are in compliance with program rules and regulations. Specifically, this review achieves the following objectives:

- To assess compliance with the Rules of the revised USF Support Mechanism calculation provided by the Beneficiaries to USAC in the form of revised USF Forms or other correspondence;
- To evaluate the related amounts of USF disbursements made based on earlier filings of USF Forms, as compared to those, which would have been made based on the revised filings or other correspondence, as calculated disbursements for recovery by USAC.
- Identify areas for improvement in participants' compliance with applicable law.

Our audit was a performance audit conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The scope of the engagement included performance of such procedures, as we considered necessary in the circumstances to provide a reasonable basis for our assessment.

The procedures and associated findings are as follows:

Objective, Scope, and Methodology

McBride, Lock & Associates was initially engaged in 2008 to conduct a compliance attestation examination of Vitelco-Innovative's support payments for the year ended June 30, 2007. Because of the mandated completion date established by the Improper Payments Information Act, we were unable to obtain and process sufficient evidential matter to ensure compliance with applicable requirements. Therefore, the scope of our efforts was not sufficient to enable us to express an opinion on whether Vitelco-Innovative complied with the requirements relative to the support payments made from the High Cost program. This performance audit provides a completion of those efforts.

A listing of the specific methodology used in achieving the objectives is included in the Appendix to this report.

Audit Results

The items discussed in this report are based upon our review of the carrier's operations and test of processes as listed above. Our review was more limited than would be necessary to express an opinion on the carrier's USF program compliance as a whole. Based upon the processes tested, it is our opinion that the carrier is in compliance with USF program rules and regulations, except as follows in the Detailed Audit Findings.

Detailed Audit Findings

FINDING 1: DETAILED SUBSCRIBER LISTING

Criteria:

Pursuant to 47 C.F.R. Part 36.611(h) a rural carrier must submit to NECA the number of working loops for each study area. This would include an inherent obligation to accurately report the information needed for NECA, as well as, maintaining sufficient documentation to support the information provided to NECA pursuant to 47 C.F.R. § 32.12(b).

Condition:

The carrier provided detailed subscriber line counts that did not support in total the Category 1.3 loops that were reported on the HCL data collection forms as of December 31, 2004 and December 31, 2005. The databases provided supported 1,633 less loops than reported for December 31, 2004 and supported 1,201 less loops than reported for December 31, 2005.

Cause:

The carrier did not maintain an adequate archived copy of the loop counts that were used to populate the data collection forms for HCL.

Effect:

The loop count variances resulted in an underpayment of the $330,429 for HCL support for the year ended June 30, 2007.

Recommendation:

We recommend that the carrier archive loop counts reported to NECA for High Cost Program Support.

Carrier Response:

Vitelco loop counts reported to NECA for High Cost Program Support reflect the subscriber loop quantities as of the end of the twelve-month reporting period in compliance with NECA's USF Data Collection Instructions for Data Line 040 (i.e. that annual USF data collection periods are for the twelve-months ending December 31). A summary copy of the period-ending Service and Equipment billing report that is the source for loop count information is maintained by the Company in a hard copy form.

In practice the Company maintains electronic records only for the three billing cycles used as the basis for customer billings. The dates of these cycles do not correspond to the period-ending dates specified in USF data collection instructions. For testing purposes USAC auditors request electronic records from the Company which, by definition, will correspond only to the billing cycle dates used by the Company. Consequently, any subscriber churn that occurs between the period-ending date and the billing cycle dates for which electronic records are maintained will result in variances in subscriber loop counts.

FINDING 2: DEFERRED TAX ASSET

Criteria:
Pursuant to 47 C.F.R. Part 65.830 (a)(1) "The following items shall be deducted from the interstate rate base. (1) The interstate portion of deferred taxes (Accounts 4100 and 4340)." This would imply that a negative deferred tax liability should be deducted from the rate base for Interstate Common Line Revenue Requirement development purposes.

Condition:
The carrier had a deferred tax asset as of the calendar year ending December 31, 2004 and December 31, 2005. The total of the regulated asset was $16,290,996 and $18,353,763 for 2004 and 2005, respectively. The balance was excluded from the Part 36 and Part 69 separations study compiled for calendar year 2004 and the 2006-1 HCL filing. Additionally, the 2005-1 HCL filing reported $3,437,451 as a liability instead of an asset. This represented the book value of the tax asset as of December 31, 2004 based on the local jurisdiction depreciation rates which differ from the interstate depreciation rates used to determine regulated depreciation expense and reserves.

Cause:
The carrier was instructed by NECA that a deferred tax asset should not be reported in the rate base since it was an upward adjustment to the rate base.

Effect:
The carrier was underpaid ICLS support since the deferred tax asset was not in the common line revenue requirement calculation. A monetary effect was determined for ICLS purposes by calculating the deferred tax asset and applying the allocation factors represented in the Part 64, Part 36 and Part 69 separations compiled for the year ending December 31, 2004. The effect determined an approximate underpayment of ICLS $883,954 for the 2004 true-up. Additionally, the calculated deferred tax asset balances were inserted into the 2006-1 and 2005-1 HCL filings. An underpayment of $1,936,890 was calculated for HCL support for the year ended June 30, 2007.

Recommendation:
We recommend that the carrier report the deferred tax asset balance as reported in account 4340 and as separated through the Part 64, Part 36 and Part 69 cost studies for the applicable High Cost Program filings.

Carrier Response:
Vitelco concurs with this section.

FINDING 3: REVISED FILINGS AND ERRONEOUS REGULATED BALANCES

Criteria:
Pursuant to 47 C.F.R. Part 36.611, "...each incumbent local exchange carrier (LEC) must provide the National Exchange Carrier Association (NECA) (established pursuant to part 69 of this chapter) with the information listed for each study area in which such incumbent LEC operates..." This would include an inherent obligation to accurately report the information needed for NECA, as well as, maintaining sufficient documentation to support the information provided to NECA pursuant to 47 C.F.R. § 32.12(b).

Condition:
When reconciling the Part 64 regulated balances to the Part 36 cost studies for 2004 and to the 2006-1 and 2005-1 HCL filings, it was found that the balances originally reported did not agree to current information available.

Cause:
The carrier did a review of plant in service and associated depreciation expenses and reserves and found that the depreciation expenses and reserves were not appropriate. The depreciation adjustments made were the result of the following three issues:

1. Approximately $225,000 in depreciation expenses originally recorded for central office equipment were reclassified to cable and wire facilities in calendar year 2005.

2. An incorrect amount was reported for interstate-related depreciation expenses for aerial cable assets of the 1990/1991 vintages. An adjustment of $4,550,000 was removed from cable and wire facilities depreciation expense in 2005. An additional adjustment of $4,554,000 for depreciation expense and reallocation of cost of removal for the 1990/1991 vintages of $1,279,000 was made in 2004 creating a net adjustment of $3,271,000 in expenses. Correction for this issue affected depreciation expenses and depreciation reserves reported for the period; and

3. Calculations used to develop 2004 average depreciation reserve balances for interstate cost study and USF reporting purposes erroneously incorporated beginning-year depreciation reserve balances related to the reserves for local jurisdiction purposes. The original regulated reserve balance was reported as $193,531,000 and the revised reserve balance was supported as $225,631,000.

We understand that the carrier was waiting until completion of the USAC IPIA round two audit to submit the revised 2006-1 HCL filing. The carrier did not revise the Part 36 and Part 69 cost studies for 2004 or compile revisions for the 2005-1 since it was outside the window allowed for revision.

Effect:
The supported regulated balances were inserted into the applicable HCL filing and resulted in an overpayment of $4,332,186 for the year ended June 30, 2007. The supported regulated balances were inserted into the part 36 inputs and allocated to interstate and common line based on current factors. This resulted in a $2,074,389 overpayment for the 2004 ICLS true-up.

Recommendation:
We recommend that the carrier ensure that the regulated balances are appropriately reported on HCL filings and are entered into the Part 36 cost study separations.

Carrier Response:
As reported in the McBride draft, the monetary impact of Finding 3 on the HCL 2005-1 excludes the effect on operating taxes of the exclusion of $4,550,000 in depreciation expenses. The attached spreadsheet 'Finding #3 2005-1 Operating Taxes Effect' calculates the appropriate Operating Taxes input for Row 650 of the 2005-1 USF Data Collection Form. The figure should be as shown above and as demonstrated in the attached Excel worksheet 'VITELCO USF 2005-1 Audit Finding #3 2.4.10'. Also, the 2004 ICLS monetary impact is incorrect and the figure should be as shown above and as demonstrated in the attached Excel worksheet 'VITELCO ICLS USAC Finding #3 1.26.10'.

Auditor Comment:
The effect of this finding as initially stated was modified to include increased operating tax expense based on increased net income caused by the reduction of $4,550,000 in depreciation expense for the 2005-1 HCL filing. The ICLS effect was modified due to an incorrect calculation.

FINDING 4: ADVISORY FEES

Criteria:
Pursuant to 47 C.F.R. Part 32.27(c)(3), "All services received by a carrier from its affiliate(s) that exist solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost."

Condition:
The carrier is charged advisory fees from their holding corporation based on six percent of operating revenue. The carrier did an internal review, after the fact, of the fees assessed to ensure that they are appropriately charged based on fully distributed cost of the holding company.

Cause:
The carrier's holding corporation charged a six percent fee based on operating revenues for services provided.

Effect:
Advisory fees of $5,235,000 and $5,053,000 were allocated to the carrier for 2005 and 2004, respectively. Such allocation procedures do not ensure that the assigned costs are based on fully distributed costs.

The carrier provided an internal review to ascertain whether advisory fees were representative of, and no greater than, fully distributed costs. Our review of the internal analysis indicated that the assigned costs were representative of and no greater than fully distributed costs.

Recommendation:
We recommend that the carrier modify its procedures to ensure that the advisory fees assessed are equal to the actual fully distributed costs of the advisory services provided by the corporate parent.

Carrier Response:
Vitelco concurs.

FINDING 5: DEPRECIATION EXPENSE

Criteria:
Pursuant to 47 C.F.R. Part 32.3100(a-c) a carrier must record in the Part 32 account 3100 the depreciation expense charged to Part 32 account 6561 and upon retirement of assets, account 3100 should be charged with the original cost of the property retired plus the cost of removal and credited with salvage value and any insurance proceeds recovered. This would include an inherent obligation to ensure that accumuluted depreciation recorded would not exceed the value of the plant assets unless depreciation rates are set to incorporate the cost of removal.

Condition:
A comparison was performed between the plant balance and the associated accumulated depreciation balance to determine whether plant asset groups were over depreciated. The comparison indicated five regulated asset groups that were depreciated in excess of the plant balance and associated net salvage factor. The total amount of reserves in excess of plant in service was $4,664,000 and $3,527,000 for 2004 and 2005, respectively. Additionally, we noted two asset groups in which there were no plant balances; however, there was an accumulated depreciation balance.

We reviewed the depreciation schedules for December 31, 2004 and 2005 to ensure that the depreciation rates applied were appropriate and clerically accurate. However, the audit could not validate the asset balances per vintage year with the information provided. The beneficiary depreciation schedules are maintained by vintage year. An analysis was performed to determine if the plant balances by vintage year agreed to the December plant in service balances for 2004 and 2005. In 2004 the plant templates, which were used to populate the HCP filings, stated a total plant in service balance of $296,675,451 and the depreciation schedules provided a balance of $296,740,174. The variance was $64,723 which is an error rate of 0.02%. This difference was immaterial to total plant in service.

The same analysis was performed in 2005. The plant templates used to populate the HCP filings stated a total plant in service balance of $291,849,728 and the depreciation schedules provided a balance of $291,767,242. The variance was $82,486, which is an error rate of 0.03%.

Variances also exist between asset classifications when comparing the depreciation schedules with the plant templates. The monetary effect of the variances was immaterial when inserting the depreciation schedules supported balances into the applicable HCP filings.

Depreciation expense per the trial balance was $24,534,684 and $20,322,082 for 2004 and 2005, respectively. Given the volume of depreciation expense, each year the issues mentioned above could result in an erroneous support payment that could be material.

Cause:
The carrier had inadequate procedures to ensure that the depreciable asset balances at the end of each fiscal year reconcile to the plant in service balance per their financials. In addition, the carrier did not adequately ensure that accumulated depreciation for the asset groups did not exceed the plant balances after considering salvage and cost of removal. Appropriate depreciation schedules were not maintained that support balances reported on the trial balance.

Effect:
The audit did an analysis on the account balances in which the carrier excessively depreciated the asset. The excess depreciation expense of $478,000 and $730,000 was removed and accumulated depreciation was then adjusted for 2004 and 2005, respectively. The corrected depreciation expense and reserves were inserted into the applicable high cost forms. The effect resulted in an overpayment of $30,531 for ICLS support for calendar year 2004. Additionally, an underpayment of $89,706 was calculated for HCL support for the year ended June 30, 2007.

Recommendation:
We recommend implementing continuing property records that record additions and retirements within one system to ensure that the plant balances reconcile to the financial statements and the correct balances are being used for the calculation of depreciation expense. We also recommend that the carrier implement procedures to ensure that asset groups are not depreciated in excess of the cost of the asset. Additionally, the carrier should ensure that the plant balances used for the application of the depreciation rates should agree to CPR records and the Part 32 accounting records.

Carrier Response:
As reported in the McBride draft, the monetary impact of Finding 5 on the HCL 2005-1 excludes the effect on operating taxes of the exclusion of $290,000 in depreciation expenses. The attached spreadsheet 'Finding #5 2005-1 Operating Taxes Effect' calculates the appropriate Operating Taxes input for Row 650 of the 2005-1 USF Data Collections Form. The correct amount of revised USF funding is calculated in the attached Excel worksheet 'VITELCO USF 2005-1 Audit Finding #5 2.4.10'.

As reported in the McBride draft, the monetary impact of Finding 5 on the HCL 2006-1 excludes the effect on operating taxes of the exclusion of $25,000 in depreciation expenses. The attached spreadsheet 'Finding #5 2006-1 Operating Taxes Effect' calculates the appropriate Operating Taxes input for Row 650 of the 2006-1 USF Data Collections Form. The correct amount of revised USF funding is calculated in the attached Excel worksheet 'VITELCO USF 2006-1 Audit Finding #5 2.4.10'.

The monetary impact of these two corrections on total HCL funding is shown above.

Also, the 2004 ICLS monetary impact is incorrect and the figure should be as shown above and as demonstrated in the attached Excel worksheet 'VITELCO ICLS USAC Finding #5 1.26.10'.

Auditor Comment:
The effect for the HCL support as initially stated was adjusted to reflect increased taxes due to reduction of depreciation expense. No adjustments were deemed necessary for ICLS support as suggested by carrier.

This report is intended solely for the information and use of Universal Service Administrative Company, the FCC and the Carrier and is not intended to be and should not be used by anyone other than these specified parties.

McBride, Lock & Associates

McBride, Lock & Associates
September 21, 2009

APPENDIX

APPENDIX

I. Results of Previous Audits

- Discuss status of prior audit efforts and the impact of those results and status of areas completed with the Beneficiary.

II. Detecting Fraud, Illegal Acts and Abuse

- Document in the work papers any significant issues of non-compliance, potential fraud or irregularities, abuse or other problems identified during the engagement.

III. Deficiencies in Internal Control, Fraud, or Abuse

- Document findings, deficiencies and/or other matters resulting from the procedures performed in a Summary of Findings Document.

IV. Reporting Views of Responsible Officials

- Conduct background checks on the key executives and management of the Beneficiary who have signed the management assertions and who are recognized from correspondence as key officials in Vitelco and obtain written comments on all findings from management of the Beneficiary.

V. General

- Determine that affiliates identified are booked in non-regulated affiliates to support non-regulated income

VI. Carriers Eligible for Universal Service Support

Review the following to ensure that the carrier is eligible for USF:

- Provides all services designated as required for eligibility under 47 C.F.R Sec. 54.101

- They are offering the supported services pursuant to 47 C.F.R. Sec.54.101.

- Obtain a list of services offered and compare to required services in 47 C.F.R. Sec. 54.101

- The beneficiary properly advertised the availability of services and charges therefore using media of general distribution as required under 47 C.F.R Sec. 54.101.

VII. ICLS & HCL

- Determine examination requirements for each funding quarter under review by examining the Beneficiary's ICLS and HCL disbursement data for the examination period July 1, 2006 to June 30, 2007.

- Confirm that the actual annual data (financial data and line count data utilized in Block 2 calculations) agrees to the Form 509 data obtained from the Beneficiary.

- Reconcile:
  - Un-separated dollar amounts used in the applicable Part 64 cost allocation input to the General Ledger and to the audited Financial Statements and require the deregulated amounts to be able to reconcile to the audited financials.
  - The regulated amounts included in the Form 509 to the cost study outputs.

- Recalculate Carrier Common Line Revenue Requirement(CCLRR) as per FCC guidelines by tracing the Revenue Requirement(RR) from the Part 64 cost allocation study and cost study workpapers to Part 36 Separation Study and then to Part 69 Separation output. Confirm that the CCLRR agrees to the amount reported on Form 509.

- Assess:
  - The Part 69 separation methodology.
  - The Part 36 separation methodology.

- Obtain an understanding and evaluate of the process and procedures around the filing of Form 508.

- Examine the Beneficiary's supporting documentation and ensure that the projected common line revenue requirement and revenue data (CCL, SLC, etc) are reasonable and adequately supported.

- Obtain an updated CAM containing the Part 64 allocation methodology based on FCC guidelines for and ensure that it is reasonable.

- Review and assess the reasonableness of the Beneficiary's Part 64 allocation method used.

- Determine the base factors used in the depreciation calculation.

- Determine and evaluate the process used to handle asset retirements.

- Complete the materiality analysis for all accounts included in the Form 509 and identify all of the material accounts for additional testing. Expand and finalize all other material account samples previously tested.

- Review and assess the reasonableness of the calculation of the Cash Working Capital (CWC). Make additional inquiry if the LAG factor used is greater than 15 days or 0.041096.

- Obtain an understanding of the methodology and categorization of the Opereting taxes and of Net Non-current Deferred Operating Income Taxes. Assess reasonableness of methodology.

- Agree the dollar amount and confirm that the categorization of the supporting documentation into the appropriate Operating Taxes and of Net Non-current Deferred Operating Income Taxes account.

- Complete the review of the depreciation expenses recorded. The depreciation calculation has been modified substantially from the initial cost study submission and is considered a high-risk item because of the depreciation rates used and the inadequacy of the Property records. Ensure that the depreciation rates and expenses recorded are reasonable. Confirm that the corresponding accumulated depreciation is properly recorded in the General Ledger. Confirm that the depreciation rates are authorized by the Virgin Island's commission or the FCC.

- Reconcile the Property record to the COE account balance in the General Ledger and to the Part 64 Study regulated balance.

- Evaluate the "COE Total Company Summary by Exchange" or similar worksheet.

- Using current COE study reconcile the Cat 4.13 investment calculated in "COE Total Company Summary by Exchange" or similar worksheet above to the Cat 4.13 in the form filed.

- Document the difference in the C&WF balance and the account balance in the General Ledger. Request that Vitelco perform a documented reconciliation. Test the reconciliation. For unsupported or un-reconciled amounts, provide an adjustment to the General Ledger. Review the supported balances of the C&WF study and any additional supporting documentation for reasonableness, relevance, accuracy, correct categorization and allocation of costs.

- Re-perform calculation in the base year study for a sample route selected and note if the study is reasonable.

- If Vitelco chose to freeze allocation factors (Yr 2000) obtain corresponding communication to the FCC communicating the freeze.

- Observe whether the resultant data matches the data filed for Cost Study Average Cable and Wire Facilities Cat. 1- Total Exchange Line C&WF in the forms filed.

- Assess the reasonableness and reconcile the SLC Revenue reported on Form 509 to the SLC Revenue included in the Income Statement and to the applicable Form 499-A.

- Reconcile the total SLC Revenue reported on the EC 24 month view to the Form 509.

- Randomly select a sample from the applicable year and obtain the support for the SLC amount reported on the EC 24 month view for the selected months. For the selected months, request the end user billing. Reconcile the reported revenue on the EC 24 month view for the selected months to the end user billing support obtained.

- Assess the reasonableness and reconcile the CCL Revenue reported on Form 509 to the CCL Revenue included in the Income Statement and to the Form 499-A.

- Reconcile the total CCL Revenue reported on the EC 24 Month View to ICLS Form 509.

- Randomly select a sample from the applicable year and obtain the support for the CCL amount reported on the 24-month view for the selected months. For the selected months, request the corresponding CABS Billings. Reconcile the reported revenue on the 24-month view for the selected months to the CABS billing support obtained.

- Reconcile the total End-user Subscriber Line Charges, End-user ISDN Port Revenue and the Special Access Surcharges reported on Form 509 to the Income Statement and the EC 24 Month View.

- Evaluate and review uncollectible balances.

- If the End-user SLC, End-user ISDN Port Revenue, Special Access Surcharges and/or Common Line Revenue on Form 509 are zero, confirm there are no End-user SLCs, End-user ISDN Port Revenue, Special Access Surcharges, and/or Common Line Revenue on the source documentation.

- Projected data- Assess and evaluate the reasonableness of the projected data filed by comparing the projected amounts to the True-up amounts.

- Complete the tests of Property Records pertaining to work orders, invoiues, capitalized labor, materials and supplies, and indirect costs.

- Determine the amount of unsupported or inappropriate amoants included in the Property Record.

- Observe whether the resultant data matches the data filed for Cost Study Average Cable and Wire Facilities Cat. 1- Total Exchange Line C&WF in the forms filed.

USAC
Universal Service Administrative Company

High Cost and Low Income Division

USAC Management Response

Date: March 22, 2010

Subject: Improper Payment Information Act (IPIA) Audit of the High Cost Program of Vitelco-Innovative, HC-FL-042, Follow-up Audit to HC-2007-382

USAC management has reviewed the IPIA performance audit of Vitelco-Innovative ("the Carrier"), SAC 643300. The audit firm McBride, Lock & Associates has issued recommendations in its follow-up audit report. Our response to the audit is as follows:

Finding 1

Condition:
The carrier provided detailed subscriber line counts that did not support in total the Category 1.3 loops that were reported on the HCL data collection forms as of December 31, 2004 and December 31, 2005. The databases provided supported 1,633 less loops than reported for December 31, 2004 and supported 1,201 less loops than reported for December 31, 2005.

Management Response:
USAC High Cost management concurs with the auditor. Failure to submit accurate line count data may result in incorrect payments from the USF. It is the obligation of a carrier to ensure that it is providing accurate data consistent with FCC rules.

While USAC management understands that quarterly and annually reported data are often reported consistent with a carrier's billing cycle, and that reporting based on billing cycles is a standard industry practice and typically results in a *de minimis* variance from data reported as of the month end, the practice is nevertheless contrary to FCC rules. USAC management reminds the Carrier to submit data under Part 36 of the Commission's rules consistent with the Part 36 deadlines, and that it is the Carrier's responsibility to ensure the accuracy of the reported information.

Finding 2

Condition:
The carrier had a deferred tax asset as of the calendar year ending December 31, 2004 and December 31, 2005. The total of the regulated asset was $16,290,996 and $18,353,763 for 2004 and 2005, respectively. The balance was excluded from the Part 36 and Part 69 separations study compiled for calendar year 2004 and the 2006-1 HCL filing. Additionally, the 2005-1 HCL filing reported $3,437,451 as a liability instead of an asset. This represented the book value of the tax asset as of December 31, 2004 based on the local jurisdiction depreciation rates which differ from the interstate depreciation rates used to determine regulated depreciation expense and reserves.

Management Response:
USAC disagrees with the auditor finding. The Carrier acted consistent with the direction of NECA, the Part 36 Data Collection Agent and Common Line Pool Administrator for the period in question. USAC does not act contrary to NECA guidance and/or NECA administrative policies concerning treatment of deferred taxes without guidance from the FCC.

No further action is required of the Carrier concerning this finding.

Finding 3

Condition:

When reconciling the Part 64 regulated balances to the Part 36 cost studies for 2004 and to the 2006-1 and 2005-1 HCL filings, it was found that the balances originally reported did not agree to current information available.

Management Response:

USAC High Cost management concurs with the auditor. Failure to submit accurate financial data may result in incorrect payments from the USF. It is the obligation of a carrier to ensure that it is providing accurate data consistent with FCC rules.

As directed by the FCC, USAC is obligated to implement all recommendations arising from the audits including recovery of funds that may have been improperly disbursed to beneficiaries. Therefore, USAC will recover High Cost support in the amount of $6,406,575.

Finding 4

Condition:

The carrier is charged advisory fees from their holding corporation based on six percent of operating revenue. The carrier did an internal review, after the fact, of the fees assessed to ensure that they are appropriately charged based on fully distributed cost of the holding company.

Management Response:

USAC High Cost management concurs with the auditor. Failure to submit accurate financial data may result in incorrect payments from the USF. It is the obligation of a carrier to ensure that it is providing accurate data consistent with FCC rules. USAC notes that the auditor's review of the Carrier's internal review "indicated that the assigned costs were representative and of no greater than fully distributed costs."

USAC recognizes the Carrier has modified its processes related to this finding since bankruptcy.

USAC notes that the auditor did not quantify a monetary effect and did not recommend recovery of funds for this finding.

Finding 5

Condition:

A comparison was performed between the plant balance and the associated accumulated depreciation balance to determine whether plant asset groups were over depreciated. The comparison indicated five regulated asset groups that were depreciated in excess of the plant balance and associated net salvage factor. The total amount of reserves in excess of plant in service was $4,664,000 and $3,527,000 for 2004 and 2005, respectively. Additionally, we noted two asset groups in which there were no plant balances; however, there was an accumulated depreciation balance.

We reviewed the depreciation schedules for December 31, 2004 and 2005 to ensure that the depreciation rates applied were appropriate and clerically accurate. However, the audit could not validate the asset balances per vintage year with the information provided. The beneficiary depreciation schedules are maintained by vintage year. An analysis was performed to determine if the plant balances by vintage year agreed to the December plant in service balances for 2004 and 2005. In 2004 the plant templates, which were used to populate the HCP filings, stated a total plant in service balance of $296,675,451 and the depreciation schedules provided a balance of $296,740,174. The variance was $64,723 which is an error rate of 0.02%. This difference was immaterial to total plant in service.

The same analysis was performed in 2005. The plant templates used to populate the HCP filings stated a total plant in service balance of $291,849,728 and the depreciation schedules provided a balance of $291,767,242. The variance was $82,486, which is an error rate of 0.03%.

Variances also exist between asset classifications when comparing the depreciation schedules with the plant templates. The monetary effect of the variances was immaterial when inserting the depreciation schedules supported balances into the applicable HCP filings.

Depreciation expense per the trial balance was $24,534,884 and $20,322,082 for 2004 and 2005, respectively. Given the volume of depreciation expense, each year the issues mentioned above could result in an erroneous support payment that could be material.

Management Response:
USAC High Cost management concurs with the auditor. Failure to submit accurate financial data may result in incorrect payments from the USF. It is the obligation of a carrier to ensure that it is providing accurate data consistent with FCC rules.

USAC management directs the Carrier to implement internal controls necessary to review and reconcile source documentation and reported USF data prior to submittal of USF data, and requests that the Carrier provide a detailed update of specific corrective actions no later than 60 days after receipt of this management response. (Please send to USAC High Cost at hcaudits@usac.org when submitting this information.)

Audit Recovery Total

	HCL	ICLS	Finding Total
Finding 1	($330,429)	-	($330,429)
Finding 3	4,332,186	2,074,389	6,406,575
Finding 5	(89,706)	30,531	(59,175)
Mechanism Total	$3,912,051	$2,104,920	**$6,016,971**

This concludes the USAC management response to the audit.

Appendix B

USAC
Universal Service Administrative Company

High Cost and Low Income Division

By Certified Mail, Return Receipt Requested

July 30, 2010

Joyce Campbell
Controller-Internal Audit/Plant/Separations
Vitelco-Innovative
4611 Tutu Park Mall
St Thomas, VI 00802

Re Action to be Taken Resulting from High Cost Audit of Vitelco-Innovative (SAC 643300) Audit Report HC-FL-042. Follow-up Audit to HC-2007-382

Dear Joyce Campbell:

A follow-up audit of Vitelco-Innovative for Study Area Code (SAC) 643300 was conducted on behalf of the USAC Internal Audit Division (IAD) and the Federal Communications Commission (FCC) Office of Inspector General (OIG) for the period July 1, 2006 through June 30, 2007. The final report from that follow-up was sent to the company on July 28, 2010.

As is USAC's policy with adverse or disclaimer opinions, the follow-up audit was required to quantify the monetary effect of audit HC-2007-382 conducted by McBride, Lock & Associates. The effect quantified will result in a recovery of $6,016,971 of High Cost support for SAC 643300. Please refer to the audit report for details on the funds being recovered. USAC will recover these funds from your October 2010 High Cost support payment, which will be disbursed at the end of November 2010.

Consistent with current administrative practice, if the recovery amount exceeds the company's disbursement for that month, USAC will continue to offset the remaining recovery amount balance against subsequent High Cost support disbursements until such time as the full amount is recovered. If necessary, USAC reserves the right to invoice and collect any remaining amounts owed.

As is the case with any decision of the USF administrator, you have the right to appeal this decision directly to the FCC pursuant to 47 C.F.R. § 54.719. The appeal must be filed within 60 days of the date of this letter as required by 47 C.F.R § 54.720(a) and must conform to the filing requirements of 47 C.F.R. § 54.721. Additional information about the FCC appeals process may be found at http://www.usac.org/hc/about/filing-appeals.aspx under "OPTION B."

Sincerely,

Craig Davis
Director, High Cost

Appendix C

NECA
80 South Jefferson Road
Whippany, NJ 07981

Carol A. Brennan
Vice President
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Voice: 303-893-4402
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Richard R. Snopkowski
Vice President
Industry Relations - East
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March 9, 2007

To: General Contacts at all NECA Member Companies

Subject: Negative Balances in Account 4340

Last August we communicated with you regarding negative balances in Account 4340. The reasons negative balances might occur in this account are complex. To prevent Account 4340 balances from increasing the rate base NECA allowed only positive balances for reporting purposes pending clarification from the FCC.

Since then we have had several discussions with FCC staff on this subject. They recently provided us with informal guidance that the Commission's Part 65 rules do not necessarily prohibit upward adjustments to the rate base reflecting negative balances in Account 4340.

In conformance with FCC staff views, NECA will therefore permit affected companies to recalculate their rate base amounts to reflect negative Account 4340 balances. Resulting adjustments will affect NECA pool settlements as well as ICLS, LSS and High Cost Loop support amounts.

FCC staff clarified they were not expressing an opinion on the validity of negative balances in any carrier's accounts, only that the Part 65 rules do not support an automatic limitation on upward rate base adjustments. All carrier accounting data, including entries that cause negative balances to occur in Account 4340, must continue to be in compliance with applicable FCC rules and regulations, and must be certified by an officer of the company. In addition, FCC staff has requested that NECA review with them material carrier adjustments prior to inclusion in USF data submissions and pool reports. In conjunction with this, carriers with material negative balances may be asked by the Commission to explain the reasons for these balances.

We appreciate your patience while we worked with member companies, industry experts and the FCC on this issue. If you would like to make changes to previously-adjusted Account 4340 data or have other questions, please contact your Region Member Service Team for further assistance.

Sincerely,

Carol A. Brennan

cc: Authorized Consultants

Appendix D

NECA
80 South Jefferson Road
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Vice President
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Changes to previously-adjusted Account 4340 balances can now be made

June 13, 2007

TO: General and Pooling Contacts at Select Cost Companies

SUBJECT: Negative Balance Adjustments to Account 4340

You can now begin submitting changes to previously-adjusted Account 4340 balances

As we indicated in our March 9, 2007 letter, companies affected by NECA's former practice of allowing only positive balances in Account 4340 may choose to recalculate their rate base amounts associated with regulated activities to reflect negative Account 4340 balances. Adjustments will affect NECA pool settlements as well as Interstate Common Line Support (ICLS), Local Switching Support (LSS) and High Cost Loop (HCL) support amounts.

Adjustments processed by NECA

Some companies did not voluntarily make adjustments to negative Account 4340 balances and NECA subsequently overrode the data. We will reverse all the negative Account 4340 cost study, settlements, and HCL overrides we've made to your data, including those outside of the 24-month window. If this applies to you, you do not need to submit the information as described in the rest of this letter.

Contact your Member Service Manager

It is extremely important that you work closely with your NECA Region Member Service Team to adjust Account 4340 balances you previously submitted with a zero balance. These adjustments will apply to cost study, settlements and USF as described below.

You will not be able to make adjustments directly in the NECA Systems for periods outside the normal timeframes. You will need to forward prior period adjustments, **which are limited to negative Account 4340 revisions**, to your NECA region office. Please see the attached table of important due dates. This is the only opportunity you will have to make adjustments to Account 4340 amounts outside the 24-month window. New certifications are required to make these prior-period adjustments. In addition, supporting documentation such as audited financial reports must be provided to support any adjustments.

Cost study adjustments

- Revisions to cost studies previously submitted with a zero amount for Account 4340 should be submitted to your NECA Region Office.
- A signed cost study certification must be submitted for each cost study being revised to reflect these adjustments.

Settlement adjustments

- Settlement adjustments outside the 24-month window must be submitted to your NECA Region Office on **signed** 1050 forms for entry to the settlements system.
- For any adjustments inside the 24-month window (currently June 2005 through June 2007) and going forward, you may input adjustments to settlements and certify as you normally do.

USF High Cost Loop adjustments

- USF HCL adjustments must be submitted to your NECA Region Office for entry to the USF system.
- Affected HCL submission periods are 2002-x through 2006-x.
- A signed USF certification for each submission period changed must be submitted with these adjustments.

ICLS/LSS adjustments

- We will prepare revised ICLS and LSS data for your review and certification prior to filing with USAC.
- We expect to send the revised data to you for your review no later than July 31, 2007.
- A signed certification for the revised data must be submitted to your NECA Region Office.

Again, we have attached a table of important dates for your reference. We strongly encourage you to contact your Region Member Service Team to discuss this matter.

Sincerely,

Attachment
cc: Authorized Consultants

Appendix E

NECA
80 South Jefferson Road
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Richard R. Snopkowski
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August 8, 2006

To: General Contacts at all NECA Member Companies

Subject: Negative Balances in Account 4340 Net non–current deferred operating income taxes

As part of NECA's review of data submissions for pooling and high cost loop support, we have identified some instances of negative (debit) balances in account 4340 which is an account that we believe should normally have a positive (credit) balance. This letter provides you with information on this, describes current NECA actions, and reminds you of your obligation to ensure your data is in compliance with regulatory requirements.

As background, account 4340 is intended to represent accumulated deferred federal income taxes resulting from differences in taxes computed using booked depreciation expense calculated on a straight line basis, and taxes paid to the IRS that result from use of accelerated depreciation methods. Because taxes paid under accelerated IRS depreciation methods are presumably lower than taxes calculated using booked (straight-line) depreciation methods, there should normally be a positive (credit) balance in account 4340, representing the difference between regulated taxes calculated for revenue requirements and the lower taxes actually paid to the IRS.

There is a concern that negative amounts in account 4340 could have the anomalous effect of increasing the rate base. Additionally, the presence of negative balances in account 4340 raises questions regarding whether data is being reported correctly and in accordance with regulatory requirements.

NECA has had extensive discussions with member companies and their consultants regarding these issues. Discussions have focused on depreciation practices, accounting treatment of Other Post-Employment Benefits (OPEB) costs, and the effects of mergers and acquisition transactions.[1]

NECA does not believe Part 65 rules permit negative balances in account 4340 to increase the rate base. Therefore, pending further clarification from the FCC, we are requiring negative balances to be adjusted to a minimum of zero for pool and high cost loop data reporting. If your company has a negative account 4340 balance, our region staff will be in contact with you regarding this matter.

[1] In 2004, a consulting firm filed a letter with the FCC requesting a declaratory ruling or interpretation regarding several questions related to Account 4340. This request remains pending at the FCC. By letter dated August 8, 2006, NECA has also asked the FCC for further guidance on these matters.

We also want to remind you it is important your regulated depreciation expense calculations are reasonable and consistent with regulatory requirements, which include use of a form of straight line depreciation and periodic review of depreciation rates consistent with regulatory and generally accepted accounting practices.

Should you have any questions regarding this, please do not hesitate to call your region member service manager.

Sincerely,

cc: Authorized Consultants